2003-SBE-002

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of	)	
	)	
Stephen D. Bragg	)	Nos. 110567 and 119357
	)	

Representing the Parties:

For Appellant: Jon H. Lieberg, Esq.

For Respondent: Charlene L. Woodward, Tax Counsel III

Counsel for Board of Equalization: Reed Schreiter, Tax Counsel

O P I N I O N

These appeals are made pursuant to section 19045[1] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Stephen D. Bragg[2] against proposed assessment of additional personal income tax in the following amounts: $48,153 for the year 1993; and, $42,658 and a late filing penalty in the amount of $10,664 for the year 1995. The appeals present two issues for our consideration: 1) Whether appellant was a resident of

[1] Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.

[2] Appellant and his former wife, Cecilia M. Bragg, filed a 1993 joint tax return. On April 7, 1994, however, appellant filed for a divorce from Cecilia Bragg; the divorce became final on July 25, 1995. Cecilia Bragg filed a separate appeal, and thus the term "appellant" as used herein refers only to Stephen D. Bragg.

California in 1993; and 2) whether respondent apportioned to California the proper percentage of income received by appellant in 1995 from a covenant-not-to-compete.

Appellant filed a 1993 California personal income tax return as a part-year resident. On the return, appellant indicated he left California and became a resident of Arizona on April 1, 1993. Appellant also filed a 1993 Arizona personal income tax return as an Arizona resident. Respondent audited appellant's 1993 California tax return and accepted appellant's claimed part-year resident status. In 1997, appellant filed an amended 1993 California tax return claiming California residency for the entire year. Appellant apparently also amended his 1993 Arizona tax return to claim nonresident status.

Upon completion of its audit, respondent issued Notices of Proposed Assessment (NPA's) to appellant for 1993 and 1995 identifying as California-source income, and thus as amounts taxable by California, amounts received by appellant from a covenant-not-to-compete and from deferred compensation.[3] In support of this position, the NPA's indicated California imposes tax on a nonresident's income derived from property or business within California. Appellant protested the NPA's, but respondent affirmed its determinations in Notices of Action (NOA's).[4] Appellant timely appealed respondent's determinations to the Board.

It appears from the briefs that the parties do not entirely agree as to the factual context of this appeal, although respondent states it does not contest many of the facts as set forth by appellant. We elicited from the briefs the essential facts surrounding this appeal. In contrast to the representation made on his original 1993 California tax return, appellant contends he resided in California from his birth in 1946 until his divorce in July 1995. Respondent counters that appellant filed California, Arizona, and federal income tax returns subsequent to April 1, 1993, stating under penalty of perjury he was a resident of Arizona. Only after appellant learned of the negative tax consequences of this decision, respondent argues, did appellant amend his returns to claim California residency in 1993.

Appellant was born in California in 1946, and resided in California until his change of residency in either 1993, 1994, or 1995. The timing of the change of residency for tax purposes is the subject of this appeal. Appellant married in California in 1970, and subsequently

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[3] Appellant did not appeal the inclusion of the deferred compensation in his California income. The current appeal, therefore, deals only with the question of appellant's residency and inclusion in California income of the covenant-not-to-compete income.

[4] Respondent apparently held a protest hearing on March 10, 2000, with respect to 1993, and a second protest hearing on July 9, 2002, with respect to both 1993 and 1995. Respondent issued a protest determination on August 13, 2002, for both 1993 and 1995, affirming respondent's determinations.

he and his wife adopted two children. The children attended California schools, with the exception of approximately three months in 1993 when one child attended school in Arizona while living with appellant.

From 1965 until 1988, appellant worked in a family-owned crane company headquartered in Long Beach, California. Appellant apparently managed the company's operations outside California, which required appellant to be outside California on a regular basis. Appellant concedes he continued to be domiciled in California during this period, and his time outside California was for a temporary or transitory purpose only. In 1988, appellant sold his interest in the family crane company in order to devote himself to fulfilling his dream of becoming a rancher. Appellant, doing business as Rancho Milagro, apparently began cattle ranching operations in Arizona and California in 1989. Although Rancho Milagro maintained some ranch operations in California, the majority of ranch property and ranch employees were located in Arizona. Appellant owned a large tract of land in Arizona and leased land adjacent thereto for purposes of grazing cattle. Apparently, this approach was more cost effective than purchasing feed due to the modest price of land in Arizona. Land prices in California precluded purchasing large tracts of land for purposes of grazing cattle.

On approximately April 1, 1993, appellant moved to the Arizona ranch property and began the process of counting and branding cattle pursuant to a contract with Farm Credit. Appellant states the contract allowed him 120 days to accept or reject a cattle count on forest service property adjacent to the Arizona property. Initially, appellant apparently slept in a bedroll and lived in a tent. Later, he lived in a double-wide ranch trailer without electricity or a telephone. Appellant managed the ranch operations, which employed approximately 20 people and consumed 70 to 90 hours per week of appellant's time. Appellant's many duties included buying, selling, vaccinating, de-licing, tagging, and gathering cattle. Appellant indicated his duties as ranch owner/manager constituted his exclusive full-time employment.

During 1993, appellant also held interests in the following: An 80-acre cutting horse ranch and a cattle feeding operation in Temecula, California; a 50-percent interest in a subchapter S corporation engaged in cattle trading and feeding in Brawley, California; a cattle hauling business in Brawley; a partnership interest in a Texas horse breeding syndicate; a partnership interest in a California limited partnership engaged in housing development; an interest in a subchapter S corporation operating a vocational school; and cattle trading in California, Arizona, and Mexico.

Beginning in 1985, appellant purchased three parcels of real property located in Temecula, California, on which appellant built a 6,500 square foot custom home and established a commercial cutting horse operation and a cattle feed operation. The residence constituted the family's primary residence. Appellant states he claimed the homeowner's exemption on the

residence through 1995. Respondent asserts appellant tried to sell the residence in 1993. Appellant counters that the attempted sale occurred in 1992 and that until he filed for divorce in 1994 he intended to return to the Temecula residence. Appellant's former wife received the Temecula residence and property in the divorce settlement. Appellant also purchased residential real property in Santa Ana, California, in 1991. Appellant's adult daughter received the Santa Ana property in the divorce settlement and now lives in the residence. Appellant purchased a ranch in Texas in 1993, which he deeded to his former wife in the divorce, and a time-share in Puerto Vallarta, Mexico, which appellant and his former wife apparently continued to co-own.

Appellant maintained bank accounts in both California and Arizona. Appellant contends during the period at issue he and his wife utilized the California accounts as their personal accounts, while the Arizona accounts served as business accounts. Appellant asserts his accountant, attorneys, physician, dentist, and chiropractor were located in California.

Appellant states he did not register to vote in Arizona until April 1995, while respondent asserts appellant cancelled his California voter registration on September 24, 1991. Respondent's auditor's notes indicate the registrar of voters for Riverside County, California, advised that appellant transferred his voter registration from Riverside County to "another county," effective September 24, 1991. A registrar of voters in Arizona apparently advised respondent that appellant was "registered to vote since [April 17, 1995]," and that prior to that date appellant was registered to vote in Yavapai County, Arizona.

Appellant and his wife maintained and registered numerous personal and business vehicles in California and Arizona. Appellant states the vehicles registered in Arizona served as business vehicles only. Appellant further indicates he was cited by Arizona authorities for driving a vehicle registered in Arizona with a California driver's license. As a result, appellant states he surrendered his California license and obtained an Arizona driver's license. Respondent contends appellant's California driver's license was suspended on April 10, 1992. Appellant counters that his California license expired on December 27, 1993, and that any suspension was for a violation in California.

Appellant filed his 1993 Arizona tax return in August 1994 and his 1993 California tax return in September 1994. Both returns, signed under penalty of perjury, indicated appellant's address as being in New River, Arizona, and his occupation as rancher. Both returns also stated appellant changed his residence from California to Arizona as of April 1, 1993. Appellant's Arizona and federal tax returns for 1994 and 1995 also indicated appellant's address as New River, Arizona.

Appellant states the parties agree that appellant was a California resident in 1992 and an Arizona resident in 1994. The question thus becomes appellant's residence in 1993.

Appellant appears to contend he was domiciled in California and was outside the state for a temporary or transitory purpose only. Respondent, on the other hand, appears to contend appellant was a domiciliary and resident of Arizona. It is against this background that we consider the rules governing residency status.

California imposes income tax liability upon the entire taxable income of every resident, and upon the entire taxable income derived from sources in California of every nonresident or part-year resident. (Rev. & Tax. Code, § 17041, subds. (a)(1) & (b).) The term "resident" includes individuals in this state for other than a temporary or transitory purpose, and individuals domiciled in this state who are outside the state for a temporary or transitory purpose. (Rev. & Tax. Code, § 17014, subds. (a)(1) & (a)(2).) The primary consideration under either facet of the definition is whether or not the individual is present in California or absent from California for a temporary or transitory purpose. (*Appeal of Anthony V. and Beverly Zupanovich*, 76-SBE-002, Jan. 6, 1976.)

The determination of whether or not an individual is present in or absent from California for a temporary or transitory purpose depends largely upon the facts and circumstances of each case. (Cal. Code Regs., tit. 18, § 17014, subd. (b); *Appeal of Raymond H. and Margaret R. Berner*, 2001-SBE-006-A, Aug. 1, 2002; *Appeal of David A. Abbott*, 86-SBE-104, June 10, 1986.) The determination cannot be based solely on the individual's subjective intent, but must instead be based on objective facts. (*Appeal of Anthony V. and Beverly Zupanovich, supra*.) In situations where an individual has significant contacts with more than one state, the state with which the individual maintains the closest connections during the taxable year is the state of residence. (Cal. Code Regs., tit. 18, § 17014, subd. (b); *Appeal of Raymond H. and Margaret R. Berner, supra*.)

Consistent with this view, the contacts the individual maintains in this and other states are important objective indications of whether the individual's presence in or absence from California was for a temporary or transitory purpose. (*Appeal of David J. and Amanda Broadhurst*, 76-SBE-036, Apr. 5, 1976.) In past decisions, the Board considered connections such as maintenance of a family home, business interests, bank accounts, retention of the services of professionals licensed under state law, membership in religious or social organizations, and ownership of real property. (*Appeal of Anthony V. and Beverly Zupanovich, supra*.) Such connections are important as a measure of the benefits and protections the individual received from the laws and government of California. (*Appeal of David J. and Amanda Broadhurst, supra*.)

The California Court of Appeal and respondent's regulations define "domicile" as the location where a person has the most settled and permanent connection, and the place to which a person intends to return when absent. (*Whittell v. Franchise Tax Board* (1964) 231

Cal.App.2d 278, 284; Cal. Code Regs., tit. 18, § 17014, subd. (c).)[5] An individual may claim only one domicile at a time. (Cal. Code Regs., tit. 18, § 17014, subd. (c).) While an individual's intent will be considered when determining domicile, intent will not be determined merely from unsubstantiated statements; the individual's acts and declarations will also be considered. (*Appeal of Joe and Gloria Morgan,* 85-SBE-078, July 30, 1985.) In order to change domicile, a taxpayer must actually move to a new residence and intend to remain there permanently or indefinitely. (*In re Marriage of Leff* (1972) 25 Cal.App.3d 630, 642; *Estate of Phillips* (1969) 269 Cal.App.2d 656, 659.)

Respondent's determinations of residency are presumptively correct, and the taxpayer bears the burden of showing error in those determinations. (*Appeal of Joe and Gloria Morgan, supra.*) The burden of proof as to a change of domicile is on the party asserting such change. (*Sheehan v. Scott* (1905) 145 Cal. 684, revd. on other grounds in *Zeilanga v. Nelson* (1971) 4 Cal.3d 716; *Appeal of Terance and Brenda Harrison*, 85-SBE-059, June 25, 1985.) If there is a doubt on the question of domicile after presentation of the facts and circumstances, the domicile must be found to have not changed. (*Whitmore v. Commissioner* (1955) 25 T.C. 293; *Appeal of Anthony J. and Ann S. D'Eustachio*, 85-SBE-040, May 8, 1985.)

Although it is difficult to enunciate a specific test for determining residency due to the variety of factual contexts in which the residency question can arise, we will reiterate the purpose of the residency rules, which underlies all our decisions, and identify a list of factors which our experience informs us can be helpful in determining where an individual's closest connections lie, and thus where an individual's presence is for other than a temporary or transitory purpose. We are mindful at this juncture that the factors serve merely as a guide in our determination of residency. Thus, the weight given to any particular factor depends upon the totality of the circumstances. The focus of our examination is to determine where an individual is present for other than a temporary or transitory purpose, not whether or not an individual satisfies a majority, or even a significant number, of the factors.

The purpose of the residency statute is to insure that all individuals who are in California for other than a temporary or transitory purpose enjoying the benefits and protection of the state should in return contribute to its support. (Cal. Code Regs., tit. 18, § 17014, subd. (a); *Whittell v. Franchise Tax Board, supra,* 231 Cal.App.2d at p. 285.) A review of prior decisions of this Board and the California courts reveal an extensive list of objective factors used to determine with which state the taxpayer's closest connections lie. The following list of factors may not be exhaustive, but certainly informs taxpayers of the type and nature of connections respondent and this Board find informative when determining residency:

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[5] The court of appeal also stated the law may assign a domicile to an individual constructively. (*Whittell v. Franchise Tax Board, supra,* 231 Cal.App.2d at p. 284.)

- The location of all of the taxpayer's residential real property, and the approximate sizes and values of each of the residences;
- The state wherein the taxpayer's spouse and children reside;
- The state wherein the taxpayer's children attend school;
- The state wherein the taxpayer claims the homeowner's property tax exemption on a residence;
- The taxpayer's telephone records (i.e., the origination point of taxpayer's telephone calls);
- The number of days the taxpayer spends in California versus the number of days the taxpayer spends in other states, and the general purpose of such days (i.e., vacation, business, etc.);
- The location where the taxpayer files his tax returns, both federal and state, and the state of residence claimed by the taxpayer on such returns;
- The location of the taxpayer's bank and savings accounts;
- The origination point of the taxpayer's checking account transactions and credit card transactions;
- The state wherein the taxpayer maintains memberships in social, religious, and professional organizations;
- The state wherein the taxpayer registers his automobiles;
- The state wherein the taxpayer maintains a driver's license;
- The state wherein the taxpayer maintains voter registration, and the taxpayer's voting participation history;
- The state wherein the taxpayer obtains professional services, such as doctors, dentists, accountants, and attorneys;
- The state wherein the taxpayer is employed;
- The state wherein the taxpayer maintains or owns business interests;
- The state wherein the taxpayer holds a professional license or licenses;
- The state wherein the taxpayer owns investment real property; and
- The indications in affidavits from various individuals discussing the taxpayer's residency.

During the year at issue, appellant owned a personal residence in Temecula with his wife for which they claimed the homeowner's property tax exemption. Appellant, however, concedes he and his wife attempted to sell this residence in 1992; appellant provided no explanation of where he and his wife intended to live if they had sold the residence. Appellant and his wife owned a second residence in Santa Ana, which later became their daughter's residence, and a time-share in Puerto Vallarta, Mexico. For a greater percentage of the period in question, appellant's wife and children remained in California and the children attended California schools. Appellant, however, spent a majority of his time in Arizona, returning to California for visits.

Appellant and his wife claimed Arizona residency on their state and federal returns filed in 1993, although they later amended the state returns to reflect California residency. The 1993 tax returns indicated an Arizona mailing address. Appellant and his wife maintained a number of bank accounts in both California and Arizona, as well as owning and registering a number of vehicles in both California and Arizona. Appellant claimed the personal (in contrast to the business) accounts and vehicles were located in California. Appellant stated he obtained all his professional services in California. Appellant indicated he owned real property in California, Arizona, and Texas.

Appellant owned business interests in California, Arizona, and Texas. Appellant admitted his exclusive full-time employment consisted of his cattle ranching duties in Arizona. Neither party discusses the nature of appellant's involvement in the other business ventures. Given his 70 to 90 hour work week on the Arizona ranch, however, we anticipate his cattle ranching duties necessarily limited his activities in the other business ventures.

Section 17104, subdivision (a), makes no distinction with respect to employment.[6] When a California domiciliary leaves the state for purposes of employment, the relevant inquiry is not the type of employment pursued, but whether or not his absence from California is for a temporary or transitory purpose. (*Appeal of Joe and Gloria Morgan, supra*.) California Code of Regulations, title 18, section 17014, subdivision (b), suggests that when a Californian is employed outside California his absence will be considered for other than a temporary or transitory purpose if the position is expected to last a long, permanent, or indefinite period of time. (*Appeal of David A. Abbott, supra*.)

Although appellant contends he went to Arizona for a 120-day period in order to brand and count cattle pursuant to a contract with Farm Credit, he also indicated his lifelong desire to be a rancher. The record indicates appellant did not return to live in California at the conclusion of the 120-day period, nor do we find any evidence to suggest appellant intended to return to California, despite the various factors discussed above that might suggest appellant maintained California residency. To the contrary, the record supports a conclusion that appellant began in 1988 to lay the groundwork for his permanent move to the Arizona ranch in 1993. In 1988, appellant sold his interest in the family business; in 1989, he purchased ranch property in Arizona and California, and began ranching operations in which the majority of the land and employees were located in Arizona; in 1990, he attended a ranching-for-profit course in Albuquerque, New Mexico; and, in 1993, appellant moved to the Arizona ranch.

[6] Section 17104, subdivision (c), does make certain distinctions for elected and appointed officials and their staffs, which are not relevant in this appeal.

In further support of our conclusion, we note appellant's family lived with him in Arizona for a period of time in 1993, but returned to California in early 1994. Appellant apparently did not make adequate provision for his family to live with him in Arizona. Appellant did not return to California with his family, nor did he subsequently return to California despite owning several residences. In fact, appellant filed for divorce from his wife shortly after her return to California, and he remains in Arizona to this day. Finally, we believe appellant's claim of Arizona residency on his 1993 tax returns merely reflects his residency status as he believed and intended it to be. We thus conclude respondent properly determined appellant was a resident of Arizona in 1993. We believe this conclusion properly reflects the fact that appellant, although a California resident at one time, left the state in 1993 for other than a temporary or transitory purpose.

The second issue presented by these appeals arises from appellant's execution of a purchase and sales agreement in September 1988 for the sale of his one-third interest in Bragg Investment Company, Inc., as well as his interests in several other corporations and family partnerships. The purchase and sales agreement contains a covenant-not-to-compete, which precluded appellant from participating in competing business activities for a period of 10 years in 30 counties in California, 2 counties in Nevada, 35 counties in Oregon, and 39 counties in Washington. The annual covenant payment was $1,333,333.00, and appellant's one-half community property interest was $666,666.50.

The parties disagreed as to the correct apportionment percentage to apply to the income received by appellant attributable to the covenant-not-to-compete. Respondent determined 84.05 percent of the covenant income should be apportioned to California, while appellant concludes 25.00 percent is more appropriate. Appellant appears to base this calculation on the fact that he forfeited his right to conduct business in four states, and thus each state counts equally in determining the apportionment of the income.

The *Appeals of Paul B. and Mary A. Milhous, et al.* (2000-SBE-003), decided November 2, 2000 (*Milhous*), represents our most recent discussion of whether California may tax income from a covenant-not-to-compete executed in connection with the sale of a business. In that appeal, we addressed three issues related to imposing tax on income from a covenant-not-to-compete. The first holding emerging from the case is that the right to compete is a property right with its situs in the location where such competition would have occurred absent the covenant. Second, we determined that the source of income from a covenant-not-to-compete is the place where the promisor promised not to act. Finally, we adopted a three-factor formula used to assign business income attributable to a state as the methodology for determining what portion of the covenant income should be assigned to California. We noted that adopting the standard three-factor apportionment formula used in the Uniform Division of Income for Tax

Purposes Act (UDITPA)[7] allowed for the use of an alternative formula in the event the standard three-factor formula would lead to an unfair representation of the extent of the taxpayer's activities in California. We stated the three-factor formula "rightfully sources covenant income to the places where the promisor forfeited the right to act in amounts that reflect the degree of corporate activity within the prohibited area." (*Appeals of Paul B. and Mary A. Milhous, et al., supra*.)[8]

Appellant contends the income from the covenant-not-to-compete is not California-source income, arguing that the word "source" conveys the idea of origin or the place where the services are actually performed. Appellant then argues respondent's use of the Bragg Investment Company apportionment factors is erroneous. Appellant states the allocation of income to California has no rational relationship to the source of the Bragg Investment Company as payee. Appellant, instead, argues that both actors and athletes use a duty-day formula and advocates this is the proper approach in this case.

Appellant indicates respondent used the alleged apportionment formula for Bragg Investment Company of 84.05 percent to calculate the proper apportionment of his income from the covenant-not-to-compete to California. Appellant contends respondent fails to provide information or documentation as to how it arrived at this percentage. Further, appellant contends the use of the apportionment formula places a burden on a taxpayer to file a return based on information to which the taxpayer may have no access.

Initially, respondent comments on an argument raised by appellant during the protest hearing. Respondent apparently disallowed losses from Tac-Fumasi Ranch, Ltd., and Health Staff Training Institute. Upon review, respondent allowed those losses as California-source losses and computed a revised tax liability for appellant, which is reflected in the figures set forth at the outset of this opinion.

Respondent indicates that appellant annually received $1,333,333 from the covenant-not-to-compete. Respondent states appellant and his wife reported this amount on his 1992 federal and California income tax returns. In 1993, however, when appellant moved to Arizona, respondent indicates appellant and his wife excluded this source of income from their California nonresident tax return. Upon audit, respondent added these sources of income back into appellant's California return and used the Bragg Investment Company 1989 apportionment factor of 84.05 percent to apportion the covenant-not-to-compete income to California.

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[7] See Rev. & Tax. Code, §§ 25120 – 25139.

[8] The "three-factor" apportionment formula found in UDITPA looks to the taxpayer's property, payroll, and sales in the states in which the taxpayer is carrying on business activities and compares those numbers with the taxpayer's total property, payroll, and sales.

Respondent states it used the Bragg Investment Company apportionment factor for 1989, the year after appellant's sale, since appellant failed to timely report the income and apportionment factor for 1988.

In *Milhous,* we adopted the three-factor formula used to assign business income attributable to a state for purposes of UDITPA as the methodology for determining what portion of the covenant income should be assigned to California. Our review of the record before us indicates that respondent properly applied our precedent from *Milhous*. Appellant fails to convince us that the standard three-factor formula is inappropriate in this case. Further, we find respondent's use of the apportionment factor for 1989 rather than 1988 appropriate, particularly in light of evidence to suggest the 1989 factor was more favorable to appellant and appellant had access to the apportionment information as a major shareholder.

In conclusion, we hold that respondent properly determined appellant to be an Arizona resident in 1993 and that respondent properly included the covenant-not-to-compete income in appellant's California income utilizing the apportionment factor for 1989.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19047 of the Revenue and Taxation Code, that the actions of the Franchise Tax Board on the protests of Stephen D. Bragg against proposed assessment of additional personal income tax in the amount of $48,153 for the year 1993, and against proposed assessment of additional personal income tax in the amount of $42,658 and a late filing penalty of $10,664 for the year 1995 are hereby sustained.

Done at Sacramento, California, this 28th day of May 2003, by the State Board of Equalization, with Board Members Ms. Carole Migden, Mr. Claude Parrish, Mr. Bill Leonard, Mr. John Chiang, and Ms. Marcy Jo Mandel present.

Carole Migden, Chairwoman

Claude Parrish, Member

Bill Leonard, Member

John Chiang, Member

*Ms. Marcy Jo Mandel, Member

* For Steve Westly per Government Code section 7.9

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